

Fiscal impact reports (FIRs) are prepared by the Legislative Finance Committee (LFC) for standing finance committees of the NM Legislature. The LFC does not assume responsibility for the accuracy of these reports if they are used for other purposes.

Current FIRs (in HTML & Adobe PDF formats) are available on the NM Legislative Website (legis.state.nm.us). Adobe PDF versions include all attachments, whereas HTML versions may not. Previously issued FIRs and attachments may be obtained from the LFC in Suite 101 of the State Capitol Building North.

FISCAL IMPACT REPORT

ORIGINAL DATE 2/10/07

SPONSOR Robinson LAST UPDATED _____ HB _____

SHORT TITLE Severance Tax Fund Investments SB 865

ANALYST Francis

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY07	FY08	FY09		
	NFI			

(Parenthesis () Indicate Expenditure Decreases)

Relates to SB 739

SOURCES OF INFORMATION

LFC Files

Responses Received From

State Investment Council (SIC)

Department of Finance and Administration (DFA)

SUMMARY

Synopsis of Bill

Senate Bill 865 allows the State Investment Council (SIC) to invest a maximum of nine percent in New Mexico private equity investments, raising the cap from the current six percent.

FISCAL IMPLICATIONS

The fiscal impact is indeterminate. While the return on private equity assets can be higher than traditional investments in equity and fixed income, the risks are much higher as well. The SIC is currently authorized to invest up to six percent of the STPF in a program that targets NM investments. One method is to invest in NM-based private equity funds with a focus on NM-based opportunities. The New Mexico Co-investment program, however, directly invests in NM companies with other private equity funds. This second NM program is considered an “economically targeted investment” or ETL.

The NM Private Investment Program (NMPEIP) has committed \$300 million, \$175 million of which has been invested. Last year the program lost its \$7 million investment in TCI Medical when that company failed. Eclipse recently received FAA certification and has begun delivery

on aircraft to clients, giving the program a significant boost. One exit strategy is for Eclipse to take the company public.

SIC (note: MM refers to millions and IRR is “internal rate of return”):

Currently the SIC has invested \$175MM in NM companies through NMPEIP, not including additional commitments and follow-on investments of approximately \$125MM. To approach allocation targets for the program, the SIC uses a multiplier to help reflect the lag between commitments and actual funding of companies or private equity funds, which commonly invest over several years, with the life of the investment relationship between limited partner and fund lasting a dozen years or more. This multiplier also helps account for return of investment through distribution triggered by various forms of investment exit (i.e. IPO, buyout, etc). The program is nearing its maximum total investment under the current 6% cap.

As of 9/30/06 the SIC has seen \$25MM in return of capital from this program, and based on current valuations has an annualized IRR of 8.31% over the life of the program.

It is very difficult to compare private equity investments to other types of investments since the value is based on an appraisal rather than being determined by the market as is the case with stocks and bonds. There is only one way to definitively assign a value to a private equity investment: when the position is liquidated either by sale or by failure. 8 of 38 companies listed in an SIC report to the House Appropriations and Finance Committee on February 1, 2007, have been liquidated or acquired. This means that only 20 percent of the number of investments through the NM private equity program (NMPEIP) can be definitively quantified.

Private equity investments are long term investments. A typical investment does not show any return for several years due to the nature of the investments. They are typically start-up companies or struggling companies that will not have any revenue in the beginning. Additional investments will come from more liquid assets whose returns are also more transparent. It is unclear where the additional funds to increase the portfolio allocation to nine percent will come from but presumably the more transparent and more liquid assets such as stocks or bonds will be the source. The severance tax permanent fund already has a 12 percent target for private equity (six for NMPEIP and six for national programs). Adding in hedge funds and real estate and the total allocation to alternative investments makes up a quarter of the portfolio.

PERFORMANCE IMPLICATIONS

SIC:

The NMPEIP is classified as an economically targeted investment, or ETI. Like all ETIs, it has dual mandates of returning profit on its investment while also assisting with economic development, industry building and job creation efforts here in NM. While the bulk of investments under NMPEIP have come in the last five years, and taking into consideration that this is significantly a young program, it appears to be having success on both sides of the equation.

The SIC's new advisor for the NMPEIP, Sun Mountain Capital, produced the following economic impact estimates, on a conservative basis, as of 12/31/06:

- The NMSIC has invested, directly and indirectly through NM Private Equity/Venture Funds, in 38 NM Companies:
 - o Those companies have hired 1,928 employees
 - o Have annual payroll of almost \$130MM
 - o Make annual NM purchases of \$49MM
 - o Have raised more than \$1 Billion from investors
 - o Pay an average salary of \$67,295 (almost X2 NM Avg.)
 - o Have an annual economic impact of \$179MM on NM

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

SB 739 increases the amount SIC can invest in film projects.

NF/csd